

**Initial Statement of Reasons for**  
**Proposed Amendments to California Code of Regulations,**  
**Title 18, Section 1588, *Seeds, Plants and Fertilizer***

**SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFIT**

Current Law

Revenue and Taxation Code (RTC) section 6358, subdivision (d) provides an exemption from sales and use tax for the gross receipts from the sale and storage, use, or other consumption of fertilizer applied to land, the products of which are to be used as food for human consumption or are to be sold in the regular course of business. For purposes of this exemption, subdivision (b) of California Code of Regulations, title 18, section (Regulation) 1588, *Seeds, Plants and Fertilizer*, defines the term “fertilizer.”

The current provisions of Regulation 1588, subdivision (b)(1) define the term “fertilizer” to include manure, commercial fertilizers, as defined in Food and Agricultural (Food & Ag.) Code section 14522, and agricultural minerals, as defined in Food & Ag. Code section 14512. Specifically excluded from the definition of fertilizer in Regulation 1588, subdivision (b)(1) are soil amendments, as defined in Food & Ag. Code section 14552, and auxiliary soil and plant substances, as defined in Food & Ag. Code section 14513.

In addition, the current provisions of Regulation 1588, subdivision (b)(2) specifically provide that, as a result of the exemption provided by RTC section 6358, subdivision (d), “[t]ax does not apply to sales of fertilizer to be applied to land (including foliar application) the products of which are to be: (a) used as food for human consumption, (b) used as feed for any form of animal life of a kind the products of which ordinarily constitute food for human consumption, or (c) sold in the regular course of the purchaser’s business.” Also, the last sentence in Regulation 1588, subdivision (b) provides that, “[w]hen insecticides are mixed with fertilizer and the mixture sold, that portion of the total price allocable to the fertilizer may be excluded from the measure of the tax if the mixed product is applied to land (including foliar application) the products of which are to be: (a) used as food for human consumption, (b) used as feed for any form of animal life of a kind the products of which ordinarily constitute food for human consumption, or (c) sold in the regular course of the purchaser’s business.”<sup>1</sup> Regulation 1588, subdivision (b) has provided that the exemption provided by RTC section 6358, subdivision (d) applies to fertilizer applied in “foliar application” since 1970.

The provisions of RTC section 6358, subdivision (d) and Regulation 1588, subdivision (b) are based on the premise that fertilizer is applied to land for the purpose of furnishing elements to be absorbed by the plant. Those elements enter into the food supply of the plants themselves and become a part of the product grown. If that product is sold, the fertilizer is not taxable as it is

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<sup>1</sup> Leaves are able to absorb fertilizer through the pores on their surface. Fertilizer is applied in a foliar application when it is applied directly to leaves (or foliage).

regarded as a sale for resale. The same reasoning applies to products grown for human consumption and to products used as feed for animal life that are food for human consumption. The absorption of the fertilizer by into the food supply of the plants themselves is different than the function of soil amendments or auxiliary soil and plant substances, which do not, in any material quantity, enter into the food supply of the plants themselves, and are not included in the definition of fertilizer.

### Proposed Amendments

#### *Need for Clarification*

The State Board of Equalization's (Board's) Legal Department has previously determined, as early as 1960, that carbon dioxide is a fertilizer when applied to land in farming. This determination is found in Sales and Use Tax Annotation<sup>2</sup> 510.0580, which provides as follows:

**Carbon Dioxide.** Carbon dioxide sold at retail to farmers for application to their land to assist in the neutralization of alkaline soils, qualifies as a "fertilizer."  
5/6/60.

The May 6, 1960, legal ruling of counsel, which is summarized in the annotation, explains that in the examined situation, carbon dioxide was sold to farmers for application to land through their irrigation systems, and used to assist in the neutralization of alkaline soils. It also explains that, at the time the legal ruling was written, the Department of Agriculture already considered carbon dioxide sold for such a purpose to be an "agricultural mineral," which is included in the definition of fertilizer for sales and use tax purposes.

More recently, a question (or problem within the meaning of Gov. Code, § 11346.2, subd. (b)(1)) has arisen as to whether carbon dioxide should be classified as fertilizer, when used by a hydroponic<sup>3</sup> farmer. In the particular case in question, the carbon dioxide is converted to a gaseous form that is delivered to the plants through a perforated tube at or near ground level. The carbon dioxide percolates up and is absorbed by the leaves of the plant (through foliar application) in order to support the life of the plant. Board staff questioned whether carbon dioxide used in hydroponic farming should still be considered an agricultural mineral, which is included in the definition of fertilizer in Regulation 1588, or whether such use makes the carbon dioxide an auxiliary soil and plant substance, which is specifically not a fertilizer under Regulation 1588. Board staff concluded that carbon dioxide used in hydroponic farming is a fertilizer because the Board had previously concluded that carbon dioxide is a fertilizer when used for the purpose of furnishing an element to be absorbed by the plant itself, thereby becoming a part of the plant's growth, and Regulation 1588 provides for fertilizer to be applied through foliar application. Board staff also concluded that it would be helpful to amend

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<sup>2</sup> Annotations, which are published in the Business Taxes Law Guide, are summaries of conclusions reached in selected legal rulings by staff counsel, as applied to specific factual situations. Annotations do not embellish or interpret the legal rulings of counsel which they summarize and do not have the force and effect of law. (See, Reg. 5700, *Annotations*.)

<sup>3</sup> Hydroponics is a subset of hydroculture and is a method of growing plants using mineral nutrient solutions, in water, without soil.

Regulation 1588 to specifically include carbon dioxide in the definition of fertilizer and specify that carbon dioxide is not an auxiliary soil and plant substance for sales and use tax purposes.

### *Interested Parties Process*

Business Taxes Committee staff drafted amendments to Regulation 1588, subdivision (b), to clarify the treatment of carbon dioxide and fertilizer used in hydroponic farming. The draft amendments suggested adding language to subdivision (b)(1) of Regulation 1588 to specifically include carbon dioxide in the definition of fertilizer and provide that carbon dioxide is not an auxiliary soil and plant substance as that term is defined in Food & Ag. Code section 14513. The draft amendments suggested revising Regulation 1588, subdivision (b) to clarify and further emphasize that the exemption may apply to sales of fertilizer applied to land or in foliar application. The draft amendments to Regulation 1588, subdivision (b)(1) also suggested adding the word “packaged” before the references to “soil amendments” to be consistent with Food & Ag. Code section 14552.

Business Taxes Committee staff subsequently provided its draft amendments to Regulation 1588 to the interested parties and conducted an interested party meeting on May 21, 2014, to discuss the draft amendments. No formal comments were submitted, however, staff worked with interested parties’ suggestions to refine the draft amendments. No further comments or concerns were expressed by interested parties.

### *September 23, 2014, Business Taxes Committee Meeting*

Subsequently, staff prepared Formal Issue Paper 14-005 and distributed it to the Board Members for consideration at the Board’s September 23, 2014, Business Taxes Committee meeting. Formal Issue Paper 14-005 recommended that the Board propose to add language to Regulation 1588, subdivision (b)(1) to specify that the term fertilizer includes carbon dioxide and provide that carbon dioxide is not an auxiliary soil and plant substance as that term is defined in Food & Ag. Code section 14513. The formal issue paper also recommended that the Board propose to revise Regulation 1588, subdivision (b) to clarify and further emphasize that the exemption may apply to sales of fertilizer applied to land or in foliar application. The issue paper also recommended that the Board update the references to “soil amendments” in Regulation 1588, subdivision (b)(1) so that they refer to “packaged” soil amendments to be consistent with Food & Ag. Code section 14552.

In addition, the issue paper recommended that the Board propose to make minor grammatical and formatting changes to the second, fourth, and fifth sentences in Regulation 1588, subdivision (b)(1). The issue paper recommended changing “Sections” and “Section” to “sections” and “section,” respectively, changing “exception” to “exceptions,” and inserting the word “the.”

Mr. John Gamper, from the California Farm Bureau Federation, appeared during the September 23, 2014, Business Taxes Committee meeting and expressed support for the proposed amendments. Ms. Jeanette Lombardo, from California Food and Agribusiness Advocates, representing Houweling’s Tomatoes, appeared along with Mr. Martin Weijters, Senior Corporate Grower, Houweling’s Tomatoes, and stated that they were available to answer any question the Members may have.

At the conclusion of the Board's discussion of Formal Issue Paper 14-005 during the September 23, 2014, Business Taxes Committee meeting, the Board Members unanimously voted to propose the amendments to Regulation 1588 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1588 are reasonably necessary for the specific purpose of addressing the issue (or problem) presented by the recent question regarding carbon dioxide used in hydroponic farming (discussed above).

The Board anticipates that the proposed amendments to Regulation 1588 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that the exemption provided by RTC section 6358 applies to carbon dioxide and fertilizer used in hydroponic farming.

The adoption of the proposed amendments to Regulation 1588 is not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 1588 or the proposed amendments to Regulation 1588.

#### DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 14-005, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its September 23, 2014, Business Taxes Committee meeting in deciding to propose the amendments to Regulation 1588 described above.

#### ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1588 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1588 at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1588 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

#### INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)(1)

As previously explained, RTC section 6358, subdivision (d) provides an exemption from sales and use tax for the gross receipts from the sale and the storage, use, or other consumption of fertilizer applied to land, the products of which are to be used as food for human consumption or

are to be sold in the regular course of business. For purposes of this exemption, Regulation 1588 defines the term “fertilizer.”

As previously explained, the proposed amendments to Regulation 1588:

- Specify in subdivision (b)(1) that the term fertilizer includes carbon dioxide;
- Provide in subdivision (b)(1) that carbon dioxide is not an auxiliary soil and plant substance as that term is defined in Food & Ag. Code section 14513;
- Clarify in subdivision (b) that the exemption may apply to sales of fertilizer applied to land or in foliar application; and
- Update the references to “soil amendments” in subdivision (b)(1) to refer to “packaged” soil amendments.

As a result, the proposed amendments are consistent with the Board’s historical treatment of carbon dioxide as fertilizer. The proposed amendments are consistent with the current provisions of Regulation 1588, which provided that the exemption may apply to fertilizer applied to land, including foliar application. And, the proposed amendments update cross-references to make them consistent with the current provisions of Food & Ag. Code section 14552. Therefore, there is nothing in the proposed amendments that would significantly change how individuals and businesses would generally behave in the absence of the proposed amendments. The Board estimates that the proposed amendments will not have a measurable economic impact on individuals and business. The Board has determined that the proposed amendments to Regulation 1588 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period. And, the Board anticipates that the proposed amendments to Regulation 1588 will promote fairness and benefit taxpayers, including manufacturers, Board staff, and the Board by clarifying that the exemption provided by RTC section 6358 applies to carbon dioxide and fertilizer used in hydroponic farming.

In addition, based on these facts and all of the information in the rulemaking file, the Board has determined that the adoption of the proposed amendments to Regulation 1588 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

Furthermore, Regulation 1588 does not regulate the health and welfare of California residents, worker safety, or the state’s environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1588 will not affect the benefits of Regulation 1588 to the health and welfare of California residents, worker safety, or the state’s environment.

The forgoing information also provides the factual basis for the Board’s initial determination that the adoption of the proposed amendments to Regulation 1588 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 1588 may affect small businesses.